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TREASURY FOR DEPSEC KIMMITT

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CONSULTATIONS

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¶1. (C) SUMMARY: On March 13, Deputy Treasury Secretary Robert Kimmitt met with Finance Minister Christine Lagarde, Bank of France Governor Christian Noyer, Elysee diplomatic and economic advisors and private sector bankers to discuss the Transatlantic Economic Council, financial market turmoil, investment policy and sovereign wealth funds (SWF), and Iran.

In response to questions about the U.S. economy, the Deputy Secretary summarized the bipartisan economic stimulus plan as

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well as public and private sector efforts to help U.S. homeowners avoid foreclosure. He alerted interlocutors to the recommendations to regulators, rating agencies, financial institutions and investors that Treasury Secretary Paulson would be making later that day on behalf of the President's Working Group on Financial Market's (PWG), as well as the Treasury Department's forthcoming blueprint for modernizing financial regulation. He stressed the importance of maintaining open investment policies that allow a constructive role for SWFs and urged stringent application of UNSC Resolutions on Iran, including their implications for treatment of Iranian financial institutions.

¶2. (SBU) French financial sector representatives expressed concern about continued financial turmoil and are looking for a "serious remedy" from the U.S. Furthering common rules and principles for financial markets, internationally, will be a priority area for transatlantic cooperation during the French EU Presidency, along with further coordination regarding third countries such as China. Elysee advisors also want more concerted action to pressure Austria, Italy, Australia, Japan, and Canada to be tougher on Iran. END SUMMARY.

Finance Ministry Says Bankers Worried over Financial Turmoil

¶3. (U) Referring to disquiet in the French banking sector, Minister of Economy and Finance Christine Lagarde said French banks are looking for a "serious remedy" to current turmoil coming from the U.S. Director General Xavier Musca relayed

concerns that asset write-downs could eventually become a vicious circle, leading to permanent devaluation across asset classes. The Deputy Secretary stressed that the USG opposes any bail out of speculators or institutions that have acted irresponsibly and is watching the markets carefully. Citing President Bush, DepSec Kimmitt said the Administration has yet to see "a good proposal" for government intervention in housing markets but is maintaining a dialogue with Congress on the issue.

French Presidency: Economic Priorities

¶4. (SBU) The Deputy Secretary highlighted the role of the Transatlantic Economic Council in feeding into the U.S.-EU summit process and urged vigorous French participation. He credited TEC with giving political momentum to mutual recognition on accounting standards and being helpful in the discussion of SWF's. Musca said that France plans to use its EU Presidency to further common rules and principles for financial markets, consistent with the work of the Financial Stability Forum. There is a premium on avoiding market distortions across the Atlantic. In this vein, he also said "mutual recognition of markets" by the SEC and European regulators was an important way forward, particularly in light of the NYSE-Euronext merger. He cautioned that EU recognition of US GAAP was still working its way through the process and that the broker-dealer issue is "not ripe" yet. Noting that France will organize nine summits with various countries for the EU, Musca highlighted the opportunity to promote common U.S.-EU economic objectives, e.g., applying pressure regarding trade and exchange rate practices during the EU-China summit in November

¶5. (SBU) Kimmitt noted that Secretary Paulson travels to Beijing soon to meet the new economic leadership and that this will be followed in June by another US.-China Strategic Economic Dialogue. Kimmitt and Musca agreed that it would be useful to consult closely. On the mutual recognition issue, Kimmitt stated that SEC Chairman Cox has been very forward leaning on international issues, but TEC had spurred this on by giving added political impetus. By early April, Treasury will release a blueprint for financial sector regulation, among other things to modernize and to cope with the multiplicity of U.S. regulatory bodies, which also impact on French and other foreign financial services businesses operating in the U.S.

GOF looks at Class Action Suits

¶6. (SBU) Lagarde mentioned that the Cabinet had just discussed class action suits with President Sarkozy and she is looking for "ammunition." She said she is opposed to measures that would make them more widespread in France, but succeeded only in limiting the concept to a trial period. For the moment, an "experiment" will be conducted with class actions in three narrowly defined areas. She said she would welcome any studies or other data that the USG might have on the relative merits of class action suits, including the degree to which awards reach class members.

Bank of France sees Continuing Market Turmoil

¶7. (SBU) Bank of France Governor Noyer said that the U.S., Europe and others need to exchange more experiences on what instruments seem to be working best. Financial markets are not currently functioning well because they lack term

liquidity, but there is growing concern over solvency, not just in the U.S. but in some European countries. Monoline bond insurers have run into trouble, as have some hedge funds,
and market players are wondering what could be next. This is partly due to the practical challenges posed by "mark to market" accounting rule that impose pain and even panic, when markets fail to generate a price that auditors can use for reference as to current value. Central banks, Noyer insisted,
do not have an answer.

Financial Regulatory Modernization Needed across Atlantic
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¶8. (SBU) While appreciating the complexity of U.S. federalism,
Noyer (who once worked on loan at the Federal Reserve Bank of New York) said he strongly believed that consolidation and simplification of U.S. financial regulation would be salutary.
His experience suggested enormous advantages to having the central bank and the banking supervisor "under one roof," permitting more detailed knowledge of balance sheets, exposures and visibility of day-to-day activities of banks. At the same time, he said, euro area bank supervision needs closer coordination, possibly with lessons learned from the Fed on developing common doctrine, methodology and rules. In his view, the Euro-area "Lamfalussy framework" needs to be transformed from being strictly advisory to a decision making body. As a first step, he said, the French would seek steps toward merger of bank supervisory functions during their EU Presidency, beginning with allowing headquarters country bank supervisors to take the lead in dealing with international banks across the Euro area.

Iran's Banks under Scrutiny

¶9. (C) In response to the Deputy Secretary's query regarding the current status of Iranian banks Sepah, Melli and Saderat in France, Banking Commission Secretary General Danielle Nouy confirmed complete GOF control of Bank Sepah, adding that the GOF is working closely with the UK and may/may move on Bank Melli even before the EU does.

¶10. (C) The Banking Commission General Counsel informed the Deputy Secretary that the Iranian Central Bank (Bank Markazi) had ceased its active refinancing of Paris-based subsidiaries

of Iranian banks, coinciding in part with the U.S.-origin civil suit which led to a temporary freeze of some Bank Markazi assets in Paris. In addition, he noted that the Banking Commission had detected no trace of other Bank Markazi
transactions in French banks. In a subsequent side conversation with Econoff, the General Counsel said that there
was no certainty that Bank Markazi had halted all other operations, only that the Banking Commission was no longer detecting any. He added that the account Markazi had opened with Bank Natixis in August 2007 about which U/S Stuart Levey had inquired in October, had been used solely for payment of specific French exports to Iran and was no longer showing activity.

Elysee Advisors Raise Iran, Finance

¶11. (C) During a working lunch, Deputy Diplomatic Advisor Damien Loras brought up the need for more coordination on Iran. Within the EU, Loras said, France, UK, and Germany are pushing hard for tightening financial sanctions on Iran. Italy and Austria have been blocking them, but France and its partners will keep at it. Loras said there is an urgent need for the U.S., France, the UK, and Germany to work together to raise sensitivity in Ottawa, Canberra, and Tokyo, which are

also "weak links." The French also believe that Emirates in general and Dubai in particular are key to increasing pressure on Iran. Kimmitt and Loras agreed that the sovereign wealth fund angle was an important lever, in that it would be more difficult for a country's SWF to invest in the U.S. or Europe if the country did not live up to its UN obligations on Iran.

¶12. (SBU) Elysee economic Advisor Ramon Fernandez agreed that the TEC is an important tool for further reducing trade and investment barriers across the Atlantic. As to specific concerns connected with financial market turmoil, Fernandez raised the negative implications of any failure of monoline bond insurers. (Note: Earlier this year, corporate and investment bank Natixis transferred its U.S. monoline subsidiary, CIFG, to its parent banks to make possible a USD 1.5 billion recapitalization to keep CIFG solvent.) Kimmitt agreed that close communication on financial sector developments with the GOF would remain important.

Bankers Roundtable

¶13. (U) Deputy Secretary Kimmit met with French bankers and representatives of U.S. banks in France for an exchange of views on financial markets. He outlined the U.S. economic stimulus package and the work on forthcoming proposals for modernization of the U.S. financial framework.

¶14. (U) Bankers raised questions about the effectiveness and impact of the economic stimulus package, given current private debt levels in the U.S. They also noted the possibility that "mark to market" rules for accounting were generating increased volatility and that changing emphasis in prudential rules for banks were generating a "boomerang" effect as assets were brought back onto balance sheets.

¶15. (U) The bankers confirmed that the French banking sector is being hit hard by market turmoil, even if not as badly as in the U.S. This is leading to problems across all asset classes. Supposed "money market" funds are also hit by subprime-related problems. There are potential sellers, but no buyers, even at the quoted prices, for some assets, with even cash markets freezing up. Investment banks simply lack the liquidity to bring assets back onto balance sheets, they explained. Retail banking is cushioning some of the impact for French banks, which have significant retail networks. French banks have been very aggressive in writing down losses, they said, but bringing off-balance sheet items back on is taking a toll in a kind of "spiraling" impact. Some expressed doubts about whether Federal Reserve action is really relieving the credit crunch.

¶16. (U) This cable has been cleared by Deputy Secretary Kimmitt.
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